

ASSESSING IMPACTS OF 2SSB 6823

EXPANDING SELF-DISTRIBUTION AUTHORITY TO OUT-OF-STATE WINERIES AND BREWERIES

ISSUE STATEMENT:

The Three-Tier Task Force was directed by the legislature to identify key issues, concerns and desired changes by the stakeholders about the current system, and to identify alternatives or modifications to the system. The Task Force was also specifically directed to research and analyze the impacts and implications of Second Substitute Senate Bill 6823 (and other suggested modifications to the system) on distributors, producers, retailers and consumers.

BACKGROUND:

In 2006, the Legislature passed Second Substitute Senate Bill 6823 (Chapter 302, Laws of 2006) authorizing out-of-state wineries and breweries to distribute beer and/or wine of their own production directly to Washington retailers. (Out-of-state manufacturers are referred to as certificate of approval holders or “COAs.”) To self-distribute, COAs must first obtain a direct shipment endorsement, for an annual fee (currently \$100).

This legislation was prompted by the District Court’s decision in *Costco Wholesale Corp. v. Hoen, et al* (2006). The House Bill Report on 2SSB 6823 states:

In Costco ... Judge Marsha Pechman of the U.S. District Court for the Western District of Washington struck down the Washington laws that allow in-state, but not out-of-state, wineries and breweries to distribute their products directly to retailers. Relying on the Supreme Court’s decision in Granholm [v. Heald (2005)], the District Court concluded that these laws discriminate against out-of-state wineries and breweries in violation of the Commerce Clause. In crafting a remedy, the District Court declined to extend the distribution privilege to out-of-state wineries and breweries or withdraw the distribution privilege from Washington producers. Instead, the District Court stayed the entry of judgment until April 14, 2006, to provide the Legislature with sufficient time to act.

This bill represents an expansion of previously existing authority for self-distribution. Licensed in-state wineries and breweries have had this authority since the mid-1930s¹ (the authority was extended to in-state microbreweries in 1997 when the statutes were changed to acknowledge this specific type of brewery.) Although a large number of in-state wineries and breweries use this authority, a relatively small portion of the wine and beer sold is sold through self-distribution.

¹ Title 47, Intoxicating Liquors, RRS § 7306-24 and RRS § 7306-24A(2), 1939.

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- In Fiscal Year 2006 (FY-06), 93 of the 97 licensed in-state breweries (96%) used this authority (2% of all beer sold in Washington in FY-06 was sold to retailers through self-distribution.)
- And, also in FY 2006, 315 of the 438 licensed in-state wineries (72%) licensed in Washington used this authority (8% of all wine sold in Washington in FY-06 was sold to retailers through self-distribution.)

Appendix A provides comparative data on self-distribution sales for the years FY01-FY06.

Self-distribution authority was not extended to authorized representatives or importers, so foreign wine and beer must still be sold to a licensed Washington distributor.² To date, 51 COAs have applied for the additional direct shipment endorsement.

In addition to granting self-distribution authority to COAs with direct shipment endorsements, the bill contained several other provisions. (These provisions already apply to in-state manufacturers that self-distribute beer or wine.):

- COAs that self-distribute are required to submit to the board monthly reports showing the quantity of beer or wine sold or delivered to retailers. Prior to this bill's passage, COAs were already required to submit monthly reports showing the quantity of product sold to distributors and importers.
- COAs that self-distribute are responsible for paying the barrel tax or liter tax on the product they sell to licensed retailers. (When product is sold through a distributor, the distributor is responsible for paying the barrel or liter taxes based on the amount of product the distributor purchases from the manufacturer.)
- COAs that self-distribute must post their prices as a distributor, and comply with uniform pricing requirements and the prohibition against quantity discounts.

The bill **allows a retailer to contract with a common carrier to pick up and deliver the product if the product is being purchased from a manufacturer.** Unless the retailer chooses to exercise this option, the manufacturer must either deliver the product to the retailer's place of business using its own vehicle or the retailer must pick up the product from the manufacturer. (Traditional distributors do not have the authority to use common carriers to deliver their product to retail customers.)³

Under the provisions of 2SSB 6823, **retailers that purchase product through self-distribution must provide the WSLCB with a monthly report on product purchased in the previous month.** Retail reporting has not been required when purchasing from in-state wineries or

² Approximately **XX**% of the wine and beer sold in Washington is imported from out of country.

³ The bill also appears to allow self-distributors to allow for a freight differential in their product prices to retailers. Testimony offered about this issue during legislative hearings suggested this is a technical error, as it could result in violations of the uniform pricing requirement. The LCB has issued an interpretive statement clarifying that, "[f]reight differentials are not allowed with prices posted by distributors or producers acting as distributors for their own product for sale to retailers as a distributor."

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breweries. Some retailers raised concerns about the impact this new reporting requirement could have on their workload. According to the LCB, however, this is additional reporting requirement is an important crosscheck. Since the LCB has never had to collect taxes from out-of-state firms, they are concerned that there is no tracking mechanism in place to ensure all COAs are accurately reporting their in-state retail sales and remitting the appropriate taxes. An on-line reporting system will be implemented to keep the impact on retailers as low as possible. The WSLCB is requiring retailers to obtain a no-cost additional endorsement to purchase directly from producers. Approximately 50 retailers have applied for this endorsement.

According to the WSLCB Fiscal Note on 2SSB 6823, the following fiscal and workload impacts are anticipated:

- Of the 714 COAs, the LCB assumes that 50% or 357 will apply for a direct shipment endorsement at a fee of \$100.
- 706 restaurants, 297 specialty shops, and 227 grocery stores (a total of 1,230 retailers – approximately 10% of the total number of licensed retailers in FY 2005) will take advantage of self-distribution of product to their establishments.
- In addition, the LCB anticipates adding 12 new FTEs to oversee the implementation of the new processes for collecting excise taxes from manufacturers; to issue licenses; and to conduct audit and enforcement activities. They estimated biennial cost of approximately \$1.6 million.

Most sections of the bill took effect on April 14, 2006. This allowed the Liquor Control Board an opportunity to work with industry and other state agencies to establish new processes to accommodate this authority. The price posting, common carrier, public disclosure provisions and the LCB reporting requirements took effect on July 1, 2006. While the new authority was implemented on the 1st of July, the LCB is working to bring the rules into compliance with the new law.

Response to the legislation is mixed. The following perspectives were expressed during recent stakeholder interviews:

- In-state wineries were particularly concerned that without this legislation, the existing authority for in-state producers to self-distribute would be eliminated. Since the economic viability of many in-state wineries depends on this method of distribution, the expanded authority was preferred to eliminating it altogether.
- Many manufacturers and retailers are concerned that the bill did not go far enough to eliminate barriers to self-distribution. The two most common complaints were that: 1) the bill does not allow central warehousing, which would facilitate less expensive and more efficient distribution of product at the retailer level, and 2) it does not allow manufacturers to contract with common carriers to deliver product. This is a reflection of a commonly expressed view by participating manufacturers and retailers that the three-tier system is less relevant in today's environment and should be relaxed or eliminated to allow a more free-market approach to the distribution and sale of beer and wine.

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- Many distributors are concerned that further expansion of the self-distribution authority will harm the traditional distributor industry and will ultimately result in loss of jobs throughout Washington. Some distributors (particularly independent wine distributors), however, agreed with manufacturers and retailers that a more flexible, free-market approach would be more appropriate in today's environment and felt they could be competitive even with the expanded self-distribution authority.
- Stakeholders from the prevention and treatment community and many distributors expressed a concern that the expanded authority represents a further erosion of the state's three-tier system. They fear that weakening the system will result in less ability to monitor and control the flow of alcohol into and throughout the state and ultimately will result in increased illegal sales and abuse of alcohol.

Analyzing the Results of 2SSB 6823

Since the provisions of the bill just recently went into effect, the impacts of changes cannot yet be analyzed. However, the Task Force *can* identify *potential* impacts and implications and recommend indicators that should be measured to assess the actual impacts when there is more experience with the changes. The LCB will likely require additional resources for ongoing data collection, analysis and reporting related to impact measures. A list of some potential impacts and corresponding measures are presented below.

1. A winery or brewery certificate of approval holder [**out-of-state winery or brewery**] with a direct shipment endorsement may now **sell their own product to retailers** (before they could sell to wine/beer distributors or importers only). [6823 sec. 4 (1)(a) and sec. 6 (2)(a) amends RCW 66.24.206 and RCW 66.24.270]

Potential Impacts	Potential Measures
Increased selection resulting from increased access by out-of-state manufacturers	# of COAs with direct shipment endorsements # of Retailers with endorsements for direct purchase
Decreased employment in traditional distributors	# of employees in beer and wine wholesale industry, as reported by ESD
Loss of tax revenues due to underreporting	Liter and barrel taxes paid by distributors; liter and barrel taxes paid by in-state and out-of-state self-distributors; COA monthly sales reports data

2. **Certificate of approval holders** are required to file a **monthly sales report** to include sales **to retailers** (previously just had to report sales to distributors) to the LCB. [6823 sec. 4(2). Amends RCW 66.24.206]

Potential Impacts	Potential Measures
Increased LCB administrative costs	# of FTEs # of transactions from self-distribution related to tax collection and enforcement

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3. **Certificate of approval holders with a direct shipment endorsement consent to the jurisdiction of Washington concerning enforcement of this chapter and all laws and rules related to the sale and shipment of wine.** [6823 sec. 4(4). Amends RCW 66.24.206] **and beer** [6823 sec. 6 (5)]

Potential Impacts

Reduced ability to enforce as a result of fewer enforcement options when dealing with out-of-state entities

Potential Measures

and type of violations issued to in-state v. out-of-state entities

4. **Any certificate of approval holder acting as a distributor of its own product shall pay liter or barrel taxes.** [sold to wine distributors and the LCB] [6823 sec.5 (1) and sec. 7 (1). Amends 66.24.210 and 66.24.290]

Potential Impacts

Loss of tax revenue due to underreporting

Potential Measures

Anticipated revenues based on previous tax collections compared to actual liter and barrel taxes paid by distributors and liter and barrel taxes paid by self-distributors

Increased effort to enforce

Cost of additional enforcement staff;
of violations

5. **Licensed retailers authorized to purchase wine or beer from a certificate of approval holder with a direct shipment endorsement or domestic winery, brewery or microbrewery shall make monthly reports to the LCB on wine/beer purchased...**[wine 6823 sec.5 (1). Amends 66.24.210 and **beer** 6823 sec.7 (1)(d) Amends RCW 66.24.290]

Potential Impacts

Increased work load for retailers

Potential Measures

of retailers reporting, and time to submit report (time associated with data collection and preparation of report.)

Improved ability to identify underreporting

of inconsistencies between self-distributor report and retailer report

6. **Licensed retailers may contract with a common carrier to obtain product directly from a domestic or certificate of approval holder** with a direct shipment endorsement (winery or brewery) acting as a distributor of its own product. [6823 Sec. 9 (2)(ii) Amends RCW 66.28.180]

Potential Impacts

Increased potential for diversion of product and illegal sales

Potential Measures

of complaints received via hotline

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General Impacts

Potential Impacts	Potential Measures
Consumers	
<ul style="list-style-type: none">• Increased consumer selection of beer and wine products• Lower retail prices	<ul style="list-style-type: none">• # of COA licensees and # of labels available in Washington• Survey of beer and wine prices
State government	
<ul style="list-style-type: none">• Decreased control over the flow of alcohol into Washington• Decreased tax revenues resulting from untraceable underreporting	<ul style="list-style-type: none">• # of illegal sales violations• Anticipated tax revenues (based on previous history) compared to actual revenues
Society	
<ul style="list-style-type: none">• Increased illegal sales of beer and wine• Increased youth consumption• Increased abusive consumption	<ul style="list-style-type: none">• # of illegal sales violations• # of underage sales violations• # of DUIs, # of traffic fatalities involving alcohol

Policy Option:

The LCB should identify and select key impact measures that can be monitored and analyzed by the Fall of 2007, in order to provide the Legislature with data about the impacts related to implementation of 2SSB 6823 (expanding self-distribution authority to out-of-state breweries and wineries).

- The LCB is encouraged to work with stakeholders and legislative staff to identify the most pertinent impact measures.
- Key impact measures should be tied to the state's policy goals and should address the impact to industry, consumers, the state, and society in general.
- To the extent possible, consideration should be given to selecting measures for which baseline data is already available.

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APPENDIX A:

A relatively small portion of wine and beer sold in Washington is sold by in-state producers through their self-distribution authority.

- Approximately 8% of all wine sold in Washington in FY-06 was sold through self-distribution (17% of all Washington-produced wine was sold through self-distribution).
- Approximately 2% of all beer sold in Washington in FY-06 was sold through self-distribution (36% of all Washington-produced beer was sold through self distribution.)

Wine Sales in gallons:						
	FY-01	FY-02	FY-03	FY-04	FY-05	FY-06
WA DOMESTIC WINERIES						
Self distributing/retail	971,192	1,424,607	2,629,599	2,688,984	1,303,506	1,720,690.00
WA Distributor	5,149,215	6,078,412	5,972,945	6,702,711	7,683,496	8,351,441
Totals:	6,120,407	7,503,019	8,602,544	9,391,695	8,987,002	10,072,131
Percentage of Wine Self Distributed Compared to all WA Domestic Wineries Sales	16%	19%	31%	29%	15%	17%
Total Sales in Washington	15,471,979	15,653,088	17,737,279	18,856,619	19,195,000	20,341,678
Percentage of Wine Self Distributed Compared to all Sales in WA	6%	9%	15%	14%	7%	8%
Beer Sales in Barrels:						
	FY-01	FY-02	FY-03	FY-04	FY-05	FY-06
WA DOMESTIC BREWERIES						
Self distributing/retail	47,012	80,656	77,660	73,093	76,460	79,315
WA Distributor	712,198	1,152,875	993,906	216,977	155,699	142,878
Totals:	759,210	1,233,531	1,071,566	290,070	232,159	222,193
Percentage of Beer Self Distributed Compared to all WA Domestic Breweries Sales	6%	7%	7%	25%	33%	36%
Total Sales in Washington	4,266,404	4,138,871	3,971,650	4,042,972	4,032,234	3,882,079
Percentage of Beer Self Distributed Compared to all Sales in WA	1%	2%	2%	2%	2%	2%